

Message Text

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16

ACTION EA-06

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FM AMCONSUL HONG KONG

TO SECSTATE WASHDC 4616

INFO AMEMBASSY LONDON

AMEMBASSY TOKYO

AMEMBASSY TAIPEI

AMEMBASSY SINGAPORE

AMEMBASSY SEOUL

C O N F I D E N T I A L HONG KONG 4173

LIMDIS

PASS TREASURY AND FEDERAL RESERVE BANK

E.O. 11652: GDS

TAGS: EFIN, HK

SUBJECT: EXCHANGE RATE POLICY

REF: HK 401

1. HKG HAS BEEN INTERVENING FAR MORE ACTIVELY IN THE FOREIGN MARKET WITH THE OBJECTIVE OF COUNTERING THE INFLOWS OF FUNDS THAT APPRECIATE THE EXCHANGE RATE ABOUT TEN PERCENT FROM OCTOBER 1974 TO THE END OF FEBRUARY.

2. THE HONG KONG DOLLAR WENT THROUGH THE FORMER LOWER INTERVENTION POINT OF HK\$4.97/US\$1 ON NOVEMBER 25. BY THE END OF JANUARY, UNDER THE INFLUENCE BOTH OF THE WEAKENING U.S. DOLLAR IN THE MAJOR CURRENCY MARKETS AND THE CHINESE NEW YEAR WHICH DRAWS MONEY INTO THE COLONY, IT HAD REACHED ABOUT HK\$4.65/US\$1, AN APPRECIATION OF 6 PERCENT. AFTER THE HOLIDAYS (FEBRUARY 11-14), IT CONTINUED TO STRENGTHEN REACHING 4.59/1 ON FEBRUARY 25. SINCE THAT TIME IT HAS STEADILY WEAKENED, RETURNING IN THE WEEK OF APRIL 14 TO 4.95/1.

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3. AFTER ITS INEFFECTUAL ATTEMPT TO MAINTAIN THE RATE AT 4.97/1 THE GOVERNMENT WITHDREW FROM THE MARKET HOPING THAT MARKET FORCES WOULD PUSH THE HONG KONG BACK TO ITS EARLIER RANGE OF QUOTATIONS. WHEN THIS FAILED TO HAPPEN, THE EXCHANGE BANKERS ASSOCIATION CUT INTEREST RATES STEADILY IN A SERIES OF STEPS IN JANUARY AND FEBRUARY PRESUMABLY WITH SOME CONSULTATION WITH THE AUTHORITIES. BUT NEITHER THESE MEASURES NOR THE EXPECTED OUTFLOW AFTER THE NEW YEAR HAVE ANY NOTICEABLE WEAKENING EFFECT. AT THE END OF FEBRUARY, WITH THE RATE CONTINUING TO APPRECIATE TO LEVELS THAT SEEMED TO HAVE NO RELATIONSHIP TO HONG KONG DETERIORATING EXPORT SITUATION, THE GOVERNMENT, IN COLLABORATION WITH THE HONG KONG AND SHANGHAI BANK STEPPED IN. BY BUYING FAIRLY STEADILY UNTIL LATER MARCH, IT HAD THE EFFECT OF DEPRECIATING THE HONG KONG DOLLAR ABOUT 5 PERCENT. SINCE THAT TIME, IT HAS WITHDRAWN AND LET THE STRENGTHENING U.S. DOLLAR IN THE EUROPEAN EXCHANGES CARRY THE BALL IN THIS MARKET.

4. HAVING REACHED THE AREA OF THE OLD PARITY, WHICH MUCH LOCAL FINANCIAL OPINION SEEMS TO BELIEVE IS ABOUT RIGHT, THE GOVERNMENT IS WONDERING WHERE IT GOES FROM HERE. ATTITUDES ARE STILL STRONGLY INFLUENCED BY THE TRADITIONAL VIEW THAT, IN HONG KONG, PRICES AND MONEY WAGES ARE SUFFICIENTLY FLEXIBLE SO THAT THE ECONOMY ADAPTS TO THE EXCHANGE RATE RATHER THAN VICE-VERSA. BUT THAT FEELING IS PARTLY BALANCED BY THE DOUBT THAT SO MUCH FLEXIBILITY REALLY EXISTS AND A CERTAIN APPREHENSION ABOUT THE EFFECTS OF KOREAN AND TAIWANESE MEASURES TO STIMULATE EXPORTS ON HONG KONG'S SALES.

5. PRESENT POLICY WOULD PROBABLY ALLOW THE RATE TO CONTINUE TO DEPRECIATE IF THAT IS THE WAY THE MARKET MOVED. IT IS NOT CLEAR WHETHER LEVELS BEYOND THE OLD UPPER INTERVENTION OF 5.20/1 WOULD BE ACCEPTABLE. THE GOVERNMENT TENDS TO BE TORN BETWEEN ITS DESIRE TO PROMOTE EXPORTS AND LOWER UNEMPLOYMENT (PROBABLY AT LEAST 10 PERCENT) AND THE FEAR THAT FOOD PRICES WILL RISE SINCE ANY DEPRECIATION OF THE HONG KONG DOLLAR WILL BE MATCHED BY AN APPRECIATION OF THE RMB, AND AS A CONSEQUENCE, THE PRICES OF FOOD IMPORTS FROM THE PRC. A TAIWAN DEVALUATION, HOWEVER, WOULD PROBABLY TIP THE BALANCE IN THE SAME DIRECTION FOR THE HONG KONG DOLLAR. GIVEN THE CONTINUED INTERNATIONAL UNCERTAINTY THE RATE WILL PROBABLY GO ON FLOATING INDEFINITELY.

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